

**Testimony of Glen Keppy
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United States Department of Agriculture**

before the

**House Committee on Agriculture
Subcommittee on Conservation, Credit, Rural Development and Research
United States House of Representatives
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Mr. Chairman, and members of the committee, thank you for the opportunity to appear before you to review the current state of Farm Loan Programs (FLP) at the Department of Agriculture. I am pleased to be able to share vital administrative and FLP accomplishments by the Farm Service Agency (FSA) over the past several years. We will provide a brief overview of our key programs, a comparative analysis of current trends versus where we were ten years ago, and perspectives of ongoing implementation challenges we face as we continue to administer FLP. Finally, we will provide an overview of the recommendations of the Administration's 2007 farm bill proposals for the Credit title.

Farm Loan Programs Overview

FSA makes direct and guaranteed farm ownership (FO) and operating loans (OL) to family-size farmers and ranchers who cannot obtain commercial credit from a bank, Farm Credit System, or other lenders (Chart 1). FSA loans can be used to purchase land, livestock, equipment, feed, seed, and supplies. Our loans can also be used to construct buildings or make farm improvements.

Under its Farm Ownership and Farm Operating Loan programs, FSA has the following amounts outstanding:

- Direct Farm Ownership: \$2.881 billion
- Guaranteed Farm Ownership: \$5.478 billion
- Direct Operating Loan: \$2.290 billion
- Guaranteed Operating Loan: \$3.748 billion

Emergency loans are also available to help producers recover from losses in counties, and contiguous counties, that are declared or designated as disaster areas or plant and animal quarantine areas. Other programs include the Indian Tribal Land Acquisitions Loan Program (ITLAP) and the Boll Weevil Eradication Loan Program.

FSA loans are often provided to beginning farmers, ranchers and applicants designated by statute as socially disadvantaged (SDA) who cannot qualify for conventional loans because they have insufficient financial resources. FSA also provides temporary assistance to established farmers who have suffered financial setbacks from natural disasters, or whose resources are too limited to maintain profitable farming operations at commercial lending rates and terms.

FSA guaranteed loans provide conventional agricultural lenders with up to a 95 percent guarantee of the principal and/or interest should the borrower default. The lender is responsible for servicing a borrower's account for the life of the loan. All loans must meet certain qualifying criteria to be eligible for guarantees, and FSA has the responsibility to monitor the lender's servicing activities. Farmers first apply to a conventional lender, which then arranges for the FSA guarantee.

FSA makes and services direct FO and OL loans. We provide direct loan customers with credit counseling and supervision so they have a better chance of success in their farming

operation. To qualify for a direct loan, the applicant must meet the eligibility criteria as well as show sufficient repayment ability and pledge collateral to fully secure the loan.

Modernization Trends

Agriculture is a very dynamic industry. Recent changes in the operating environment have been enormous. This requires that FSA also must be aggressive in keeping pace and must modernize our operations.

Briefly, our recent accomplishments include:

Farm Business Plan. Business plans for FSA borrowers are now processed through a Web based system. This provides access to “real time” data on our portfolio while sharing data among our automated systems. This system also provides a reporting option. We have established some standard reports that reveal the financial status of our portfolio. In the future, we will be developing additional reports that will allow us to assess the impact of economic changes in the agricultural sector so that we can anticipate their impact on our borrowers. This also allows lenders to electronically provide information to FSA on guaranteed loans. In the future, we expect that borrowers and applicants using this software will be able to provide their financial information to us via the Web.

This system has allowed our loan officers to conduct more extensive and meaningful financial analysis of our borrower’s portfolios thus enhancing their opportunities for success and graduation to commercial lending. We recently added a new feature that allows our loan officers to order applicant credit reports from the three major reporting companies through this system. We expect this to improve the application processing time.

Currently, we are moving all of our automated systems to the Web. When this project is completed we will eliminate duplicate data collection and farm loan services will be delivered more efficiently. Our employees will be able to conduct USDA business from any location where there is broadband, WIFI or dial-up Internet access. This will allow us to conduct business with producers at locations and times convenient to them. Additionally, this information will be stored on a centralized server allowing employees to quickly access portfolio information and provide real time management reports.

Guaranteed Loans are processed under the Guaranteed Loan System (GLS), an integrated software system shared between USDA’s Rural Development and FSA. GLS has been Web enabled since May 2001, with ongoing refinements to make it more efficient and user-friendly. Lenders will soon have access to the system to electronically submit status reports.

FLP Streamlining. FLP is in the final stages of streamlining regulations on its direct loan programs (guaranteed loan regulations were streamlined in 1999). This streamlining

effort will provide FSA employees with additional time to devote to servicing other customer needs. Once implemented, it will deliver the following three key benefits:

- 1) Consolidate and reorganize 13 Code of Federal Regulations (CFR) parts into five parts and 42 instruction manuals into four handbooks;
- 2) Modify loan making and servicing processes within current statutory authorities; and
- 3) Improve, rather than eliminate, existing program processes.

Farm Loan Programs Risk Assessment (FLPRA). FSA developed a risk based oversight program to identify areas for potential risk in our portfolios. State reviews are conducted by national FLP staff once every five years and by state office staffs who must review one-third of their service centers each year. Potential risk areas are separated into three broad categories:

- 1) Program Management;
- 2) Program Objectives; and
- 3) Financial Integrity.

Data is obtained from the FLP automation sources. This process was piloted in FY 2005 and implemented in FY 2006. To date, fourteen states and 187 service centers have been reviewed.

800-Number. In February 2006, FSA introduced a new 24-hour, toll-free line that borrowers can call to get information on their accounts. They can check their current account status, loan balance, due date of the next installment, historical data on their various loans, and general information – such as the amount of interest paid – to help them in calculating their income taxes.

Comparative Framework: That Was Then – This Is Now

The quality of our portfolio has improved significantly due in large part to our modernization efforts, better customer service and the dedication of FSA employees, as well as the much improved farm financial environment of the past seven years.

FLP continues to emphasize the importance of processing applications in a timely manner. Between FY 2001 and FY 2006, FLP reduced its direct application processing timeframes by thirteen days (30 percent), and reduced guaranteed processing timeframes by five days (28 percent).

Loss Rates. In FY 2006, losses in the direct loan program fell to their lowest level since 1986 – just 2.9 percent. FSA has experienced a steady decrease in direct losses over the past decade, from a high of 11 percent in FY 1996 (Chart 2).

Losses for FY 2006 in the guaranteed loan program were 0.4 percent, the lowest level since 1985 (Chart 3).

Delinquency Rates. As with losses, the direct loan delinquency rates are at historic lows for the past two decades at 8.1 percent for FY 2006 (Chart 4). This is the result of steady and dramatic decreases from a 23.8 percent delinquency rate in FY 1995. The decrease was facilitated by expanded authority, since 1996, to offset federal payments, salaries and income tax refunds to delinquent borrowers.

In the guaranteed program, the FY 2006 delinquency rate was 1.45 percent, the lowest since 1995 (Chart 5).

Foreclosures. Foreclosure rates continue to be very low in the direct loan program. In 2006, FSA participated in 198 foreclosures, including cases initiated by other lenders against individuals who also had loans with FSA. This represents less than one-third of 1 percent of the agency's direct loan caseload, and is a slight decrease from the previous two years, when the rate was just over the one-third of 1 percent level.

Inventory Properties. Inventory farm properties – those that have come into government ownership through voluntary conveyance or foreclosure – are also at historic lows with just 100 farms covering 18,000 acres in FY 2006. Just a decade ago, FSA held nearly 1,800 farms covering 598,000 acres. Many of those inventory properties were sold to established and beginning farmers, providing those individuals with prime opportunities to expand or create new operations.

Graduation Rates. Federal law requires FSA to “graduate” its borrowers to commercial credit when they have made sufficient progress to be able to qualify for loans from other lenders. They are assisted by the agency in refinancing their direct loans with FSA guaranteed loans from commercial lenders. Some 2,824 direct loan borrowers (3.83 percent) were able to graduate in FY 2006, a percentage comparable to the rates over the past ten years.

Beginning and SDA Farmer Participation. FSA has annual performance goals in place for field offices that reflect the Government Performance and Results Act requirements. These goals include increasing lending to beginning and SDA farmers and ranchers.

FSA continues to provide assistance to minority farmers in greater proportions than their demographic percentage of the total farming population (Chart 6 / Table 1).

FSA has increased the amount of loan funds obligated to beginning farmers and ranchers and to SDA applicants. The FSA direct loan beginning farmer caseload increased from 3,474 in 1995 to 16,828 in 2006. During this same period the FSA direct SDA caseload increased from 3,260 to 14,327. Guaranteed caseloads for beginning farmers and ranchers and SDAs were first reported in 1997. The FSA guaranteed beginning farmer caseload increased from 3,617 in 1997 to 8,236 in 2006. During this same period, the FSA guaranteed SDA caseload increased from 1,730 to 3,014.

Independent Study Results

Now, these improvements just cited are not our only assessments. Independent research verifies that FSA direct loan programs are operating effectively, and make a significant,

positive impact on the groups they are intended to serve. Researchers at the University of Arkansas recently conducted a comprehensive review of FSA direct loan programs. In one facet of their research, they studied loan originations in fiscal years 2000-2003 and found that 92 percent of the direct loans originated in those years went to small farmers, that is, farmers with less than \$250,000 in gross sales. They found that although FSA farm loans assist only 4 percent of all farmers, because FSA farm loans are targeted to family farmers, an estimated 18 percent of all non-hobby family farmers depend on FSA for at least a portion of their financing.

The researchers also examined longer term outcomes of FSA's FLP. They reviewed the status of farmers who received loans between 1994 and 1996. The research found that 78 percent of the loans made during that period have been satisfied. They also found that of all the loan recipients during that period, only 11 percent left farming involuntarily. Bear in mind that all of these farmers cannot get commercial financing when they come to FSA for a direct loan.

In one key finding, the researcher concluded that the direct FLPs are largely servicing the intended clientele based on the agency's mission, given that direct loan recipients typically have weakness in their financial profiles and would likely have difficulty qualifying for commercial credit. Study findings, and other indicators in this testimony, clearly show that FSA's FLPs are doing a remarkable job of accomplishing what can only be described as challenging program objectives, as well as controlling operating costs and losses.

Ongoing Challenges

As we look ahead in the ever-changing environment, FSA will face significant and ongoing challenges in the years to come. Some of the most prominent are term limits, loan limits, staffing constraints, and finding ways to help beginning farmers overcome the barriers to enter production agriculture.

Term Limits. The statute presently limits a borrower to direct OL loans in each of seven years, with an additional one-time, two-year waiver on an individual case basis:

- There are more than 7,000 FSA borrowers who can only receive direct operating loan assistance one more year from the agency; and
- There are more than 11,000 FSA borrowers who can only receive direct operating loan assistance two more years from the agency.

Without FSA direct loan assistance, many of these borrowers may be forced out of farming as they may not have access to the capital necessary for them to conduct their farming operations.

The statute presently limits borrowers with guaranteed OL loans to 15 years of eligibility, with receipt of a direct OL loan also counting as a year of eligibility for guaranteed OL loans. The 2002 Farm Bill suspended enforcement of this provision through December 31, 2006, but Congress recently extended the suspension through September 30, 2007.

Once the statutory suspension expires, more than 3,800 borrowers are ineligible for any further assistance. An additional 1,600 borrowers will become ineligible for further assistance after 2007.

Staffing Challenges. We estimate that as many as 26 percent of FSA's current loan officers will be eligible to retire by the year 2009.

On average, it requires about two years to hire and train a loan officer in order to provide the level of effective supervision, expertise and customer service needed to maximize every opportunity for success for FSA borrowers. The two year training window for new loan officers complicates an already cloudy staffing forecast.

FSA's portfolio and borrowers could be exposed to financial risk if retirement attrition projections for loan officers are even marginally accurate. A large percentage of FSA borrowers are either beginning farmers or financially stressed borrowers who need financial supervision. FSA loan officers provide this supervised credit which requires a complete knowledge of FSA programs, finances, and agriculture enterprises.

2007 Farm Bill

The unique features of FSA farm loan programs have made them a key resource for beginning and socially disadvantaged farmers for many years. The Administration's farm bill proposals for the Credit title will enhance the ability of farm loan programs to meet the special needs of beginning and socially disadvantaged farmers and ranchers. Several obstacles make it difficult for these two groups to launch production agriculture operations. There are several underlying factors that create barriers, including:

- 1) Initial capital investment;
- 2) High land values;
- 3) Inability to access credit;
- 4) Lack of farm succession planning;
- 5) Increasing interest rates; and
- 6) Higher energy costs.

The farm bill proposals will make farm loan programs even more useful in overcoming these barriers and help these farmers and ranchers become established and financially secure.

The specific provisions are:

Targeted funding. We recommend increasing the statutory target for direct OL funds for beginning and SDA farmers to 70 percent. Additionally, we propose increasing the direct FO target for beginning and SDA farmers to 100 percent. Increasing the target levels would provide additional assurance that beginning and SDA farmers have financing options to purchase farmland and then operate those farms. We also recommend changes to the timing and method of pooling funds to assure that the funds may be used to meet the needs of these applicants nationwide.

Beginning Farmer Downpayment Loan Program. Our proposal would enhance the existing Beginning Farmer and Rancher Downpayment Loan Program to increase the opportunities for the next generation of farmers. The proposal would reduce the existing four percent interest rate to two percent. The first annual payment would be deferred for one year. The \$250,000 cap on the value of property that may be acquired would be eliminated, and the minimum producer contribution would be reduced from 10 percent of the property purchase price to five percent. In addition, the program would be expanded to include socially disadvantaged farmers and ranchers as eligible applicants. These changes would make the program a better fit for the situations that confront beginning and socially disadvantaged farmers.

Loan Limits. The maximum amount an individual may receive in FSA Farm Loan Programs is specifically prescribed in the Consolidated Farm and Rural Development Act (CONACT). The CONACT direct operating loan limits have not changed since 1984; the current limit is \$200,000. Direct FO loan limits were increased to the current \$200,000 level in 1978.

The maximum direct loan amounts specified in the CONACT have not kept pace with increases in the cost of farm land and production inputs. We propose to increase the existing limits of \$200,000 for direct FO and \$200,000 for direct operating loans to a maximum of \$500,000 for any combination of the two loan types. The higher, combined limit will allow a better matching of loan type, amount, and purpose to an individual applicant's credit needs.

We believe these three proposals will improve access to capital, providing more opportunities for and improving the competitiveness of beginning and socially disadvantaged farmers.

Conclusions

Through modernization efforts, maintaining focus on program objectives, and the hard work and dedication of FSA employees, FSA farm loan programs has made great strides in improving program performance. Loan failures and losses have declined which is a strong indication that the program mission of helping farmers become successful is being accomplished. At the same time, increased assistance to small, beginning, and minority farmers, reflects remarkable success as well.

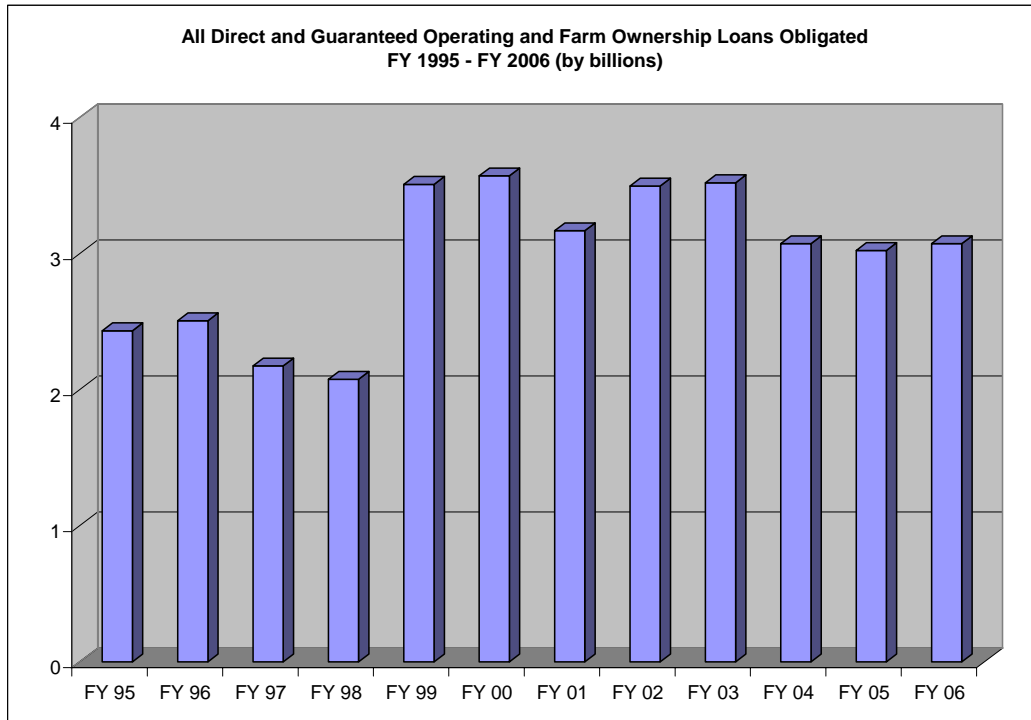
However, more challenges lie ahead. Government resources are increasingly limited and the agriculture production landscape is changing. The structure of agriculture continues to change as most farms become larger and increasingly more reliant on technology, resulting in increased capital needed to gain entry. The cost of assets required to operate a farm continue to increase as well. These changes pose significant barriers and challenges to the groups that FSA farm loan programs are intended to assist. These issues create major challenges for the agency as well, since the success of the program depends on those whom the programs are intended to serve. To keep pace with these

changes, we will continue efforts to modernize the delivery system, and to refine and adjust program requirements and operations to maximize the opportunities for our nation's small, beginning, and socially disadvantaged farmers and ranchers.

Because of our rural delivery system and experienced loan officers, the FSA farm loan programs staff is well positioned to continue the high quality delivery of existing programs and new initiatives to assist small, beginning, and minority family farmers. We look forward to working with this Committee to address the challenges we face in accomplishing this worthwhile mission to strengthen family farmers and rural America.

APPENDIX

Chart 1



\$ Billions

Chart 2

DIRECT LOAN LOSSES
(Includes Percentage of Direct Unpaid Principal)

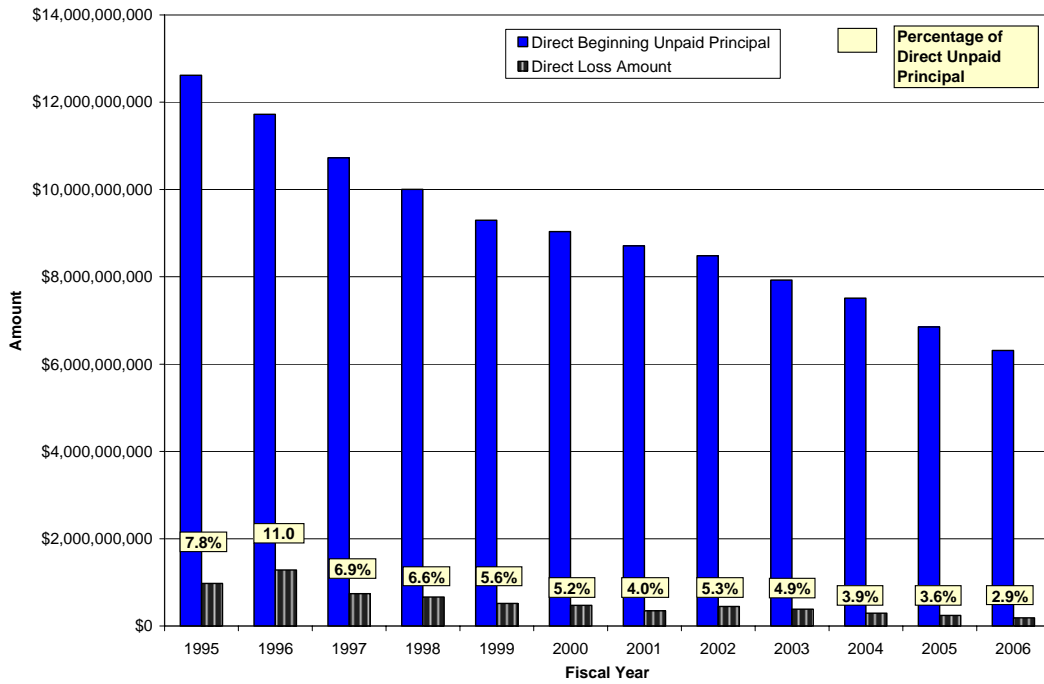


Chart 3

GUARANTEED LOAN LOSSES
(Includes Percentage of Guaranteed Unpaid Principal)

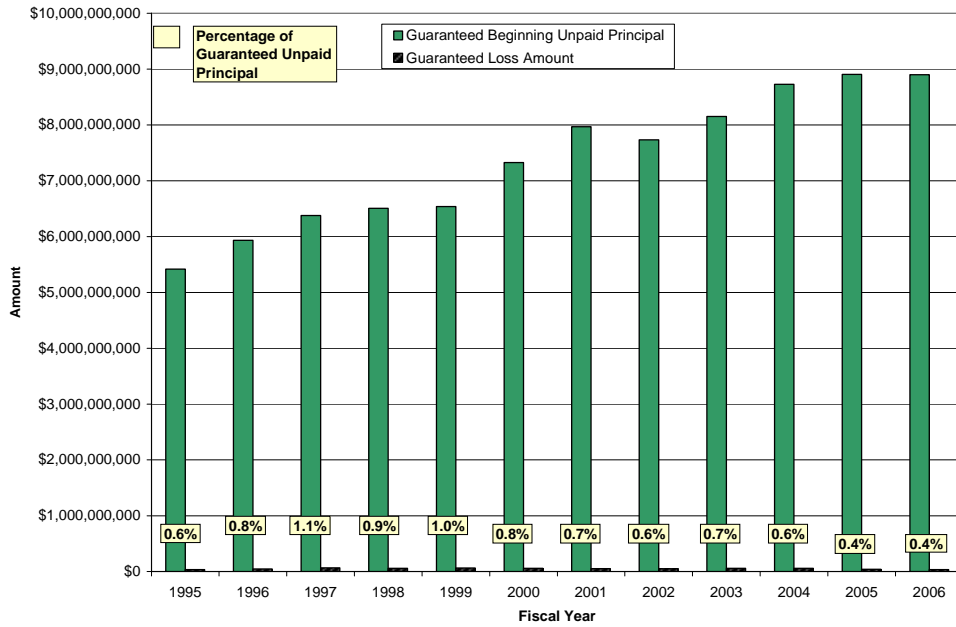


Chart 4

DIRECT LOAN DELINQUENCY (Includes Percentage of Total Direct Portfolio)

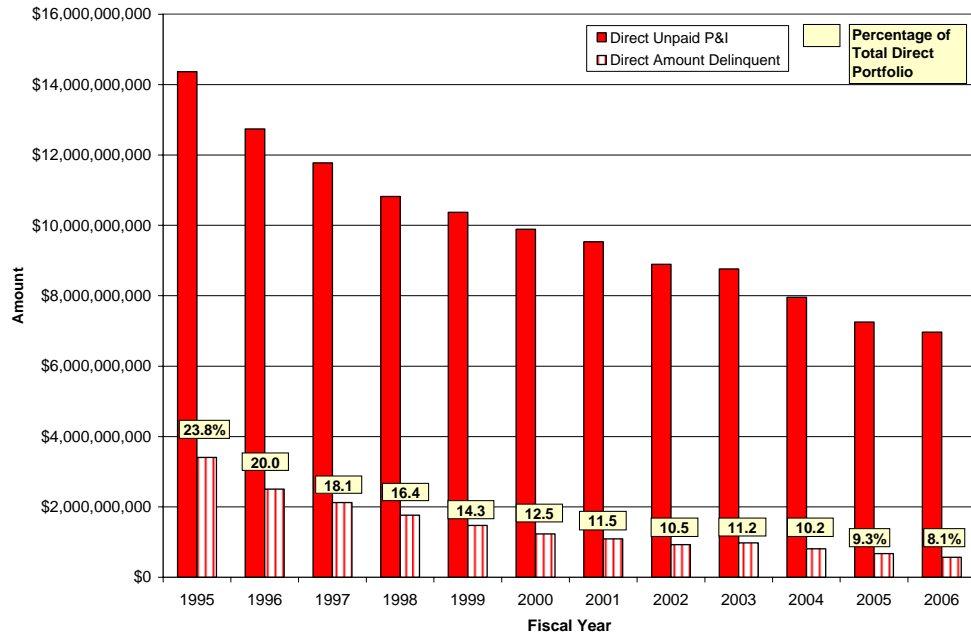


Chart 5

GUARANTEED LOAN DELINQUENCY (Includes Percentage of Total Guaranteed Portfolio)

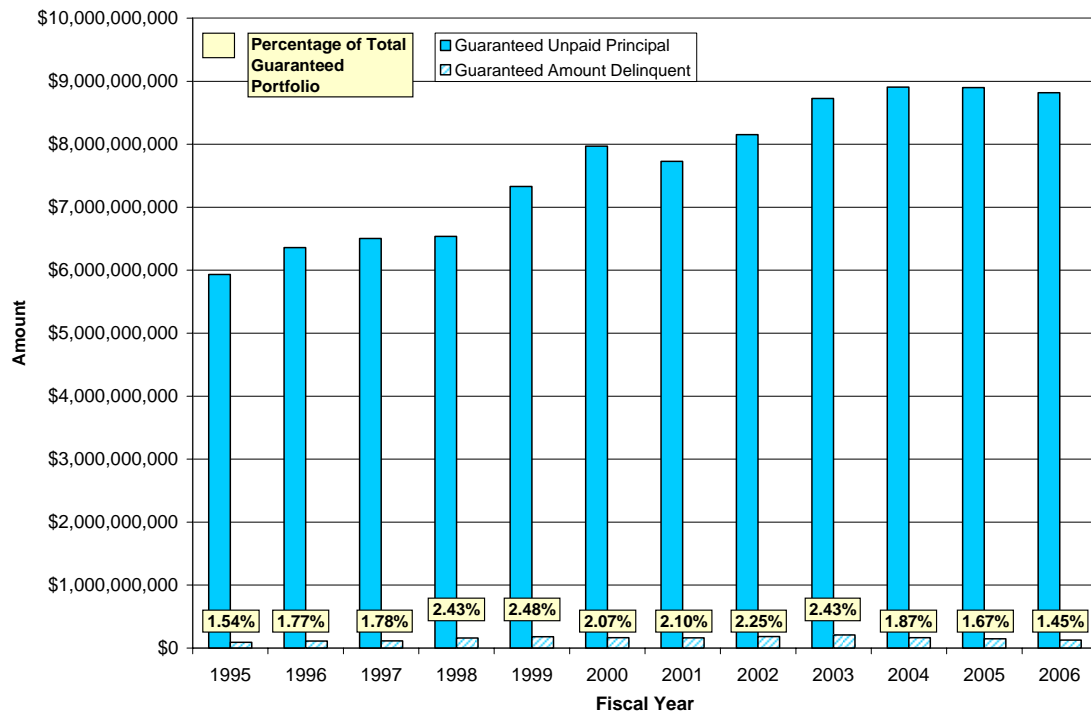
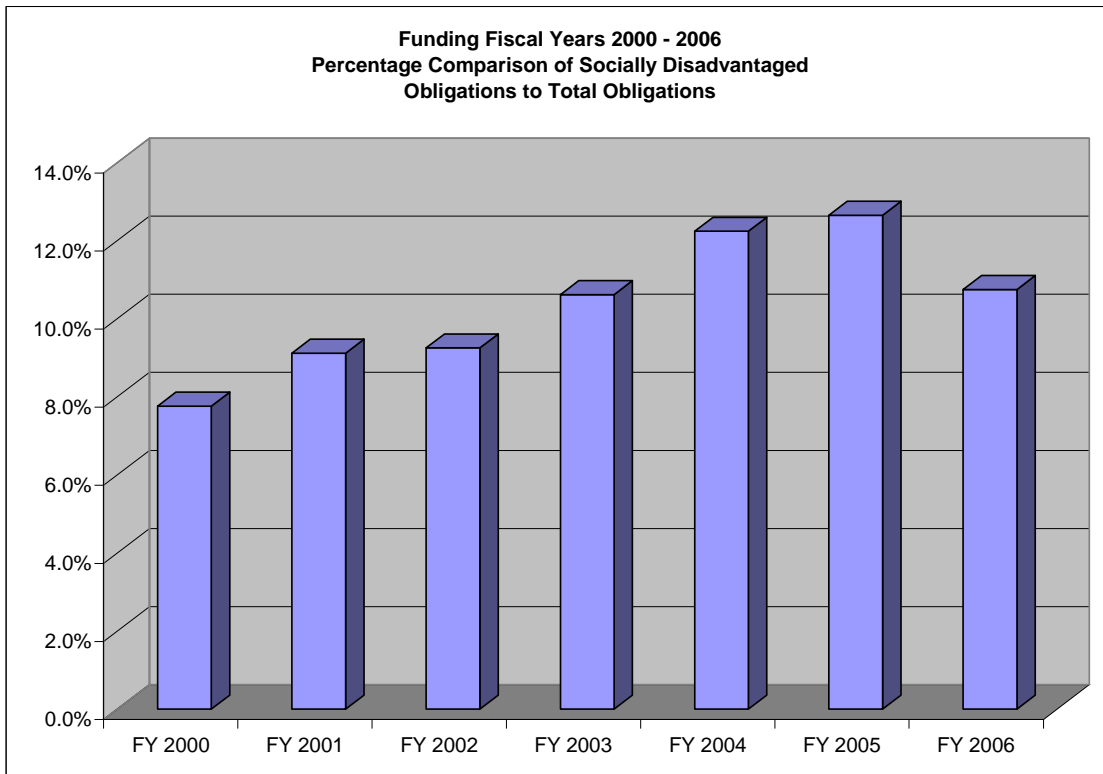


Chart 6



Percentage of Obligations to Total Obligations

Chart 6 / Table 1

**FY 2006 BORROWER CASELOAD BY RACE
(As Compared to 2002 Census Data)**

	Percent of 2002 Census Population	Percent of FY 2006 Direct Caseload	Percent of Population being served by FSA Direct Farm Loans	Percentage of FY 2006 Guaranteed Caseload	Percent of Population being served by FSA Guaranteed Farm Loans
White	97.46	88.23	3.06	95.28	1.70
Black	1.37	3.63	8.96	0.62	0.79
Asian/Hawaiin	0.44	0.86	6.57	2.24	8.79
Amer Ind/Al Nat	0.73	2.95	13.67	1.49	3.53
* Hispanic	N/A	4.21	N/A	0.28	N/A
Other	N/A	0.12	N/A	0.10	N/A

* Hispanic Americans are not a separate category within the 2002 Census of Agriculture; therefore, no reliable comparison can be established.